

Latest trends in identifying permanent establishment (2) 2/13/23



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This article rounds off what we wrote last week.

Personal income tax (PIT) and national social insurance contributions

A local company's board member may receive remuneration for board duties from a non-resident company.

PIT is payable in the company's residence country under international law: article 16 of the double tax treaty provides that the income earned by a member of the board or other similar management body must be taxed in the country where the company registered.

The obligation to pay national social insurance contributions may shift, however, to the country where the person carries out their work.

Thus, if a foreign company's board member performs board duties in Latvia, their remuneration could be exempt from Latvian PIT if there's an effective double tax treaty.

a Latvian tax resident is liable to report their income through the annual income tax return. In this case the State Revenue Service (SRS) could send the foreign company employing the individual a request to explain why the company hasn't registered a permanent establishment (PE) in Latvia.

A PE derogation for remote work due to Covid-19

During the Covid-19 related travel restrictions, the OECD issued guidelines to explain that employees working in any jurisdiction other than the one in which their employer is located because of the pandemic-related restrictions should not be the only factor that drives a PE. The guidelines focused on the fact that the restrictions the governments imposed because of Covid-19 were exceptional and temporary.

Although the travel restrictions have now been lifted, many employees continue working remotely, so it's even more important for companies to assess PE risk associated with such staff.

In general, the OECD still supports the position resulting from Covid-19 that if workers carry out their job duties remotely, this doesn't necessarily create a PE in another jurisdiction. However, to avoid a PE, two criteria must be met:

- We need to assess whether the home office is used regularly and constantly for conducting the foreign company's business (i.e. whether the person's activities have a periodic or casual nature – so-called auxiliary activities).
- We need to understand whether the facts and circumstances imply that the foreign company

has asked the person to conduct the company's business at their home, without making it possible for them to work from the company's office.

Accordingly, if the employer doesn't ask the worker to use their home office for conducting the company's business and actually makes it possible to work from the office (e.g. the company has an office in another country but the employee voluntarily chooses to work from the country where he has set up his home office) then this should not create a PE in the worker's home country.

From a practical perspective, if an employee carries out most of their work from their home in one jurisdiction, rather than from the office that's available to them in another jurisdiction, then their home office should not be treated as available for conducting the company's business, because the company hasn't demanded that their home be used for conducting the company's business.

This may not apply to the company's board/council members or procurators, or to persons that carry out selling and contracting activities.

Tax authorities' stance on PE

On 21 November 2022 the Danish tax authority issued an advance tax ruling SKM2022.557.SR, partly analysing whether two Norwegian companies may be treated as having their effective management seat in Denmark and partly assessing whether those companies have a PE in Denmark.

Background

The CEO of the companies worked from his home in Denmark for three days and from the office in Norway for two days a week, using a hybrid work model. The CEO worked overtime in Norway, so he was found to have spent 65% of his working hours in Norway and only 35% in Denmark. Also, the CEO owned a 20% stake in the Norwegian companies.

The ruling

The Danish tax authority stated that the effective management seat of the companies was not in Denmark because their day-to-day management functions were performed in Norway, where most of the staff were located. However, the Danish tax authority found that both Norwegian companies had a PE in Denmark because they were performing a key function in Denmark.

Recommendations

Companies that have employees working remotely in another country should carefully consider how having a PE may affect their current business model. One of the ways to mitigate PE risk is set out below:

1. Provide a place of work to conduct business in the country where the company, branch or PE is located and emphasise that working from home in another country is the person's own choice.
2. Put a procedure in place to identify situations where an employee carries out work abroad and create an obligation to report this to the employer.
3. Draw up a list of countries with increased PE and other tax risks, such as countries outside the EU/EEA and countries that don't have an effective double tax treaty with Latvia.
4. The company's policy should include notes or appendices analysing key issues associated

with PE risk.

The latest case law examined in this article shows how easy it is to create a PE in another jurisdiction and how important it is for any company to carefully consider the implications of its decisions allowing remote cross-border work at staff and management level. The tax authorities are now just beginning to identify the risks and implications, so we should expect many more PE rulings.

If your company needs help in assessing and preventing PE risk, please reach out to PwC senior tax manager Irena Arbidane or senior tax consultant Alise Dzintare.